KPMG

TAX FLASH NEWS

13 May 2016

India and Mauritius sign a protocol amending the India-Mauritius tax treaty

Background

On 10 May 2016, India and Mauritius has signed a protocol[1] amending the India-Mauritius tax treaty (the tax treaty) at Mauritius. The key features of the protocol are as under:

Capital Gains

Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a state may be taxed in that state. In other words, gains from transfer of shares of an Indian resident company may be taxed in India. The tax rate on such capital gains arising during the period from 1 April 2017 to 31 March 2019 shall not exceed 50 per cent of the tax rate applicable on such gains in the state of residence of the company whose shares are being alienated. A table of impact on key tax rates is given in the Annexure.

Limitation of Benefits

A Limitation of Benefit (LOB) clause has been introduced which provides that a resident of a state shall not be entitled to the benefits of 50 per cent of the tax rate applicable in transition period (1 April 2017 to 31 March 2019) if its affairs were arranged with the primary purpose to take advantage of such benefits.

A shell/conduit company claims to be a resident of a state shall not be entitled to the benefits of the transition period. A shell/conduit company is any legal entity falling within the definition of a resident with negligible or nil business operations or with no real and continuous business activities carried out in that state.

A resident of the state is deemed to be a shell/ conduit company, if its expenditure on operations in that state is less than INR 2.7 million (Mauritian Rupees 1.5 million) in the immediately preceding 12 months from the date the gains arise. Such resident is deemed not to be a shell/conduit company if it is listed on the recognised stock exchange of the state or its expenditure on operation is equal to or more than above-specified amounts.

Permanent Establishment

The service permanent establishment (PE) clause has been introduced in the India-Mauritius tax treaty. Accordingly, PE shall include the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or connected project) for a period or periods aggregating more than 90 days within any 12 months period.

Fees for Technical Services

The existing tax treaty does not have 'Fees for Technical Services' (FTS) related article. The protocol has introduced FTS article which provides that FTS may be taxed in the resident state.

[1] Source - http://mof.govmu.org

However, if the beneficial owner of the FTS is a resident of the other state the tax charged by the source state shall not exceed 10 per cent of the gross amount of the FTS. FTS has been defined to mean payments of any kind (other than those mentioned in Articles 14 and 15) as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.

If such beneficial owner of the FTS carries on business in the other state through a PE situated therein, or performs in that other state independent personal services from a fixed base situated therein, and the right or property in respect of which the FTS are paid is effectively connected with such PE or fixed base, the provisions of Article 7 or Article 14 as the case may be, shall apply.

FTS shall be deemed to arise in a state when the payer is that state itself, a political sub-division, a local authority, or a resident of that State; unless the FTS is related to a PE/fixed base situated in the source state.

If the FTS exceeds the arm's length price, the excess part of the payments shall remain taxable according to the laws of each state.

Interest

Interest may also be taxed in the state in which it arises, and according to the laws of that State, but if the beneficial owner of the Interest is a resident of the other state, the tax so charged shall not exceed 7.5 per cent of the gross amount of the interest. Further interest arising in a state shall be exempt from tax in that State provided it is derived and beneficially owned by any bank, resident of the other state carrying on bona fide banking business. However, this exemption shall apply only if such interest arises from debt claims existing on or before 31 March 2017.

Other Income

The existing tax treaty gives the right to the resident state to tax other income. However, the protocol provides that other income of a resident of a state may also be taxed in the source state.

Exchange of Information and Assistance in the Collection of Taxes

The existing article on exchange of information has been updated by the protocol in line with the current international standards. Further a new article namely 'Assistance in the collection of taxes' has been introduced.

Effective date in India

The provisions of article dealing with PE, interest, FTS, LOB and other income shall be effective in India[2] in respect of income derived in any fiscal year beginning on or after 1 April next following the date on which the Protocol enters into force[3]. The provisions of an article dealing with 'capital gains' shall have effect in both the states from the assessment year 2018-19 and subsequent assessment year.

Our comments

Recently, the protocol has been signed between India and Mauritius to amend the India-Mauritius tax treaty. This will substantially change taxability of the transactions effected through Mauritius.

The protocol will, inter-alia, impact taxation of shares of listed Indian companies held by Foreign Portfolio Investors (FPIs) from Mauritius. Currently, the benefit of capital gains provisions under the tax treaty is available to such FPIs. As per the protocol, capital gains from such investments shall be taxable in India after 1 April 2017 at a concessional rate of 50 per cent, subject to the LOB article. This article prescribes conditions for availing the benefit of concessional rate and is made applicable during the transition period only. From 1st April, 2019 and thereafter capital gains would be taxed at normal rates.

[2] In the case of Mauritius, in respect of income derived in any fiscal year beginning on or after 1 July next following the date on which the Protocol enters into force

[3] This Protocol shall enter into force on the date of the later of the notifications, by each of the states to the other of the completion of the required procedures.

Taxation of gains on transfer of capital assets other than shares of an Indian company are not impacted.

In terms of India's comprehensive economic cooperation agreement with Singapore, residence based capital gains tax treatment together with LOB clause exists in respect of shares of an Indian company. However, such agreed tax treatment is co-terminus with the current residence based capital gain taxation under the India-Mauritius tax treaty. With the amendment to the tax treatment of capital gains on transfer of shares of an Indian company under the India-Mauritius tax treaty, the similar benefit of the India-Singapore tax treaty may also automatically comes to an end.

The protocol also inserts the following articles/clauses:

- Service PE clause which states that furnishing of services through employees or other personnel, where activities of that nature continue (for the same or connected project) for a period or periods aggregating more than 90 days within any 12 month period will result into PE.

- FTS article which provides that FTS may be taxed in the resident state. However, if the beneficial owner of the FTS is a resident of the other state, the tax charged by the source state shall not exceed 10 per cent of the gross amount of the FTS. FTS article has been introduced in line with most of the Indian tax treaties.

- Interest income article has been amended to remove general exemption with respect to interest income beneficially owned by taxpayers engaged in a bona fide banking business of one state sourced from the other state. It provides an exemption from taxation in the source state on interest income arising from debt claims existing on or before 31 March 2017. Further, the Protocol restricts the source country taxation rights on interest (including interest earned by banks) to a maximum of 7.5 per cent on the gross amount of interest.

- The ‘Other Income’ article which provides that other income of a resident of a state may also be taxed in the source state.

The Protocol replaces the existing article on ‘Exchange of Information’. Further, a new article on ‘Assistance in the collection of taxes' has been introduced which reflect India’s stand in respect thereof.

Please see Annexure on the next page

Annexure

Table of impact on key tax rates for capital gains on transfer of shares:

<table>
<tr><th>Type of shares</th><th>Type of gains</th><th>Type of Market</th><th>Investments in shares acquired before 1 April 2017</th><th>Capital gains arising during the transition period i.e. 1 April 2017 to 31 March 2019[4] for which investment made on or after 1 April 2017</th><th>Capital gains arising after the transition period i.e. after 31 March 2019 for which investment made on or after April 2017</th></tr>
<tr><td rowspan="4">Listed</td><td rowspan="2">Short term</td><td>On Market</td><td rowspan="7">Grandfathered (existing benefit continues)</td><td>8.11% (50% of 16.22%)</td><td>16.22%</td></tr>
<tr><td>Off Market</td><td>For FPI – 16.22% (50% of 32.45%)

For Non-FPI - 21.63% (50% of 43.26%)</td><td>For FPI – 32.45%

For Non- FPI - 43.26%</td></tr>
<tr><td rowspan="2">Long term[5]</td><td>On Market</td><td colspan="2">Exempt under domestic law subject to Securities Transaction tax (STT)</td></tr>
<tr><td>Off Market</td><td>5.41% (50% of 10.82%)</td><td>10.82%</td></tr>
<tr><td rowspan="2">Unlisted</td><td colspan="2">Short term</td><td>For FPI – 16.22% (50% of 32.45%)

For Non-FPI - 21.63% (50% of 43.26%)</td><td>For FPI – 32.45%

For Non- FPI - 43.26%</td></tr>
<tr><td colspan="2">Long term[6]</td><td>Not Applicable[7]</td><td>10.82%</td></tr>
</table>

[4] Benefit of 50 per cent reduction in tax rate shall be available subject to fulfillment of LOB Article of the Protocol
[5] Capital Gains will be long-term if shares are sold after 12 months
[6] Capital Gains will be long-term if shares are sold after 24 months.
[7] In order to consider unlisted shares as long-term, the period of holding shall be of 24 months. In the transition period, this condition does not get fulfilled for capital gains arising on shares acquired after 1 April 2017. Therefore, the benefit of 50 per cent reduction in tax rate shall not be available.

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